No. 90-1458

FILED
JUN 6 1991
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

THE WILLIAMS COMPANIES, INC. and ITS DOMESTIC SUBSIDIARIES, including WILLIAMS NATURAL GAS COMPANY, WILLIAMS PIPE LINE COMPANY, WRC OF MISSOURI, INC., AGRICO CHEMICAL COMPANY, WILLCO, INC. (EDGCOMB METALS COMPANY), WILLBROS TERMINAL COMPANY, and WRC OF CROWN CENTER, INC.,

Petitioners,

vs.

DIRECTOR OF REVENUE, STATE OF MISSOURI,

Respondent.

On Petition for a Writ of Certiorari
to the Supreme Court of Missouri

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

Respondent submits that the instant case presents the following questions:

1. Whether the Missouri Supreme Court erred in upholding the Director of Revenue's denial of the petitioners' request for permission to file amended returns on a consolidated basis where (1) petitioners had previously filed separate Missouri corporate income tax returns for the years in question and (2) petitioners did not meet the Missouri statutory requirements for filing a consolidated return?

2. Whether the Missouri Supreme Court erred in upholding the Director of Revenue's assessment, which apportions capital gain income derived from the sale of stock to Missouri under the Multistate Tax Compact, based on its finding that the seller and the issuing corporation constituted a unitary business, where the seller did not own a controlling stock interest in the issuing corporation, but under the facts of the case, did exert actual control over the issuing corporation?

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The respondent, Duane Benton, Director of Revenue of the State of Missouri, respectfully requests this Court to deny the Petition for Writ of Certiorari, seeking review of the decision of the Supreme Court of Missouri in this case. That opinion is reported at 799 S.W.2d 602 (Mo. banc 1990).

REASONS WHY THE PETITION SHOULD BE DENIED

1. The decision of the Supreme Court of Missouri concerning the Missouri statutory requirements for filing a Missouri consolidated income tax return can be sustained on an independent ground of state law, as demonstrated by the decision of the Missouri Administrative Hearing Commission herein, and therefore, resolution of this case would not require this Court to decide any substantial federal questions.

The Missouri statutory provision at issue in this case, § 143.431.3(1), Revised Statutes of Missouri ("R.S.Mo.") 1986, states:

> 3. (1) If an affiliated group of corporations files a consolidated income tax return for the taxable year for federal income tax purposes and fifty percent or more of its income is derived from sources within this state as determined in accordance with section 143.451, then it *may elect to file* a Missouri consolidated income tax return. The federal consolidated taxable income of the electing affiliated group for the taxable year shall be its federal taxable income. (Emphasis supplied).

Thus, the decision to file a consolidated return lies with the taxpayer, who must affirmatively choose this method of reporting its income.

Here, the petitioners each filed a separate Missouri corporate income tax return for the years in question. Petitioners' brief at 8-9. They later filed amended returns on a *combined* basis accompanied by claims for refunds. Petitioners' Brief at 9. Along with the amended returns was a request to file consolidated returns. Jt. Ex. 1A, ¶¶ 27, 28, 31-34. Appellants have insisted throughout the proceedings in this case that there are

significant differences between combined reporting and consolidated returns. It follows that their amended returns should not be considered to be equivalent to consolidated returns. In short, petitioners did not choose to file consolidated returns for the years in question. This means that even if the requirements for filing a consolidated return which are included in Section 143.431 were unconstitutional, petitioners could not be afforded the relief they are seeking, since they have already elected to file separate returns.

This circumstance was considered by the Missouri Administrative Hearing Commission in its disposition of this case. The Commission, it should be noted, accepted the contention that Missouri law afforded the petitioners an opportunity to file their returns on a combined or consolidated basis, notwithstanding the fact that less than fifty percent of the affiliated group's income was derived from sources inside this state. The Commission stated:

> Certainly, both combined reporting and consolidated returns are potentially available to Williams, for the Director is vested with broad discretion to allow—or require—whatever means of reporting best reflects the taxpayer's tax liability under the circumstances.

Petitioners' Brief at 37a. Nevertheless, the Commission ruled against the petitioners, because Missouri law required that they choose their filing method before filing their original returns. Petitioners' Brief at 37a. The Commission noted, that

> [o]nce a taxpayer has elected to file on a particular basis, that election is irrevocable. *Bartlett & Company Grain v. Director of Revenue*, 649 S.W.2d 220 (Mo. 1983). The Director cannot be compelled—and may lack authority—to permit taxpayers to avoid the adverse effects of their own lack of foresight by belated amendment of their returns.

Id.

Thus, before it may consider whether to strike down Section 143.431, as urged by the petitioners, this Court must face the identical issue decided by the Commission, namely: does Missouri law permit petitioners to reverse their decision to file separate Missouri corporate income tax returns? The resolution of this question is purely a matter of state law and is dispositive of this case.

The petitioners concede that whether they may file on a combined basis does not present a federal question. Petitioners' Brief at Note 2. Their petition focuses instead on whether they may file consolidated returns for the years in question. The Missouri Administrative Hearing Commission decision, as noted above, demonstrates that regardless of whether Section 143.431.3(1) is unconstitutional, petitioners may not file consolidated returns for the years in question. This issue was not considered by the Supreme Court of Missouri, which instead directed its attention to the issue of whether the statute was unconstitutional. Finding it to be constitutional, the Missouri Court affirmed the Commission's decision without any further discussion of this other issue.

Because the question of whether petitioners may file a consolidated return can thus be disposed of on a state ground, it does not present a basis for the exercise of this Court's jurisdiction under 28 U.S.C. § 1257(a). Additionally, because petitioners filed amended returns on a combined basis, and did not file consolidated returns, the disposition of the consolidated return issue by this Court would constitute an impermissible advisory opinion.

2. The decision of the Missouri Supreme Court concerning the Missouri statutory requirement for filing a Missouri consolidated return is consistent with the decisions of this Court and the other cases cited by the petitioners, and thus does not present a basis for granting the petition.

To support their claim that Section 143.431.3(1) favors in-state business over out-of-state business, the petitioners posit a hypothetical situation. Petitioners' Brief at 16-17. The problem with this example, however, is that it ignores the fact that the figures which the petitioners refer to as the "Missouri tax base" of the two hypothetical groups of corporations would be subject to formula apportionment before any tax were imposed. *See* § 143.451, RSMo 1986, Petitioners' Brief at 109a; § 32.200, RSMo 1986, Petitioners' Brief at 79a-104a. The two groups of affiliated taxpayers derive different proportions of their income from Missouri sources. The applicable apportionment factors, however, cannot be determined from the facts given. Thus, it is not possible to calculated what the true tax outcome would be in this situation.

It is axiomatic that the greater the proportion of income a taxpayer derives from Missouri sources, the larger its apportionment factor will be. Thus when apportionment is added to the equation, it is clear that a taxpayer who earns forty-nine percent of its income from Missouri sources and a taxpayer who earns fifty-one percent of its income from Missouri sources are simply *not* similarly situated vis-a-vis this state's income tax.

As the foregoing discussion illustrates, the effect of Section 143.431.3(1) cannot be accurately determined outside the context of apportionment. Section 143.431.3(1) is an integral part of the Missouri scheme for calculating the Missouri taxable income of a group of affiliated taxpayers. Thus, it is significantly different from the statutes at issue in the cases noted by the petitioners, since the Missouri statute does not impose a tax nor

grant a credit or exemption. *Cf. Westinghouse Electric Corporation v. Tulley*, 466 U.S. 388, 104 S. Ct. 1856, 80 L.Ed.2d 388 (1984); *Maryland v. Louisiana*, 451 U.S. 725, 101 S. Ct. 2114, 68 L.Ed.2d 576 (1981); *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 97 S. Ct. 599, 50 L.Ed.2d 514 (1977); *Delta Air Lines, Inc. v. Department of Revenue*, 455 So.2d 317 (Fla. 1984); *Comptroller v. Armco, Inc.*, 521 A.2d 785 (Md. App. 1987). Moreover, consolidated returns do not necessarily result in tax savings. Indeed, the cases cited by the petitioners on this topic demonstrate that this Court has repeatedly been asked by taxpayers to relieve them from the burden of being treated as a consolidated group for tax purposes. *See, e.g., Container Corp. of America v. Franchise Board*, 463 U.S. 159, 103 S. Ct. 2933, 77 L.Ed.2d 545 (1983).

This Court has recognized that formula apportionment is an "imperfect prox[y] for an ideal which is not only difficult to achieve in practice,but difficult to describe in theory." *Container Corp.*, 463 U.S. at 182. In keeping with this principle, this Court has determined that "the Constitution imposes no single formula on the States" when it comes to determining the state taxable income of a group of related corporations. *Id.* at 164 (citing *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 446, 61 S. Ct. 246, 250, 87 L.Ed. 267 (1947)).

As the Missouri Supreme Court noted, the Missouri scheme follows a middle course between formula apportionment and separate accounting, and is neither arbitrary nor irrational. As the Court explained,

> Section 143.431.2 is fashioned on the principle that formula apportionment of the income of a unitary affiliated group is more likely to be "fairly apportioned, non-discriminatory, sufficiently connected with the taxpayer's state activities, and fairly related to state benefits provided the taxpayer," *Mobil*, 445 U.S. at 443, when the affiliated group derives

> the majority of its income from in-state sources. Conversely, when the unitary group's income derives primarily from sources outside the state, formula apportionment of the income of only those subsidiaries with direct relationships to the State yields a corpus of income more reasonably related to the group's activities within the state.

799 S.W.2d at 605.

The petitioners also attack the Missouri Court's view that "the legal form in which a taxpayer clothes its business is one of its own choosing. The fact that a form that is well suited to some purposes does not also minimize Missouri taxes does not violate the Commerce Clause of the United States Constitution." 799 S.W.2d at 605. This conclusion is consistent with the view that taxpayers who come within Section 143.431.2(1) and those who do not, are not otherwise similarly situated in regard to the Missouri income tax, and thus the statute is not discriminatory. Furthermore, it is a correct statement that nothing in Missouri law requires appellants to conduct their business through a variety of corporate subsidiaries. The decision to do business through these subsidiaries was the choice made by the petitioners, based upon numerous factors, one of which might have been taxation.

Finally, it should be noted that even if this Court were to grant the petition and rule that the fifty percent source of income requirement of Section 143.431 is unconstitutional, the result of such a ruling would be that no taxpayers would be entitled to file a consolidated return in Missouri. This is because the challenged portion of the Missouri statute is not severable. As the Missouri Supreme Court has explained:

> The test of the right to uphold the law, some portions of which may be invalid, is whether or not in so doing, after separating that which is invalid, a law in all respects complete and susceptible of constitutional enforcement is

left, which the legislature would have enacted if it had known that the excised portions were invalid. *State ex rel. Audrain County v. Hackman*, 275 Mo. 534, 543, 205 S.W.2d 12, 14 (Mo. banc 1988).

Simpson v. Kilcher, 749 S.W.2d 386, 393 (Mo. banc 1988).

The Missouri legislature most certainly would not have enacted Section 143.431.3 minus the provision challenged by the petitioners. It was the obvious intent of the legislature to place a limit on corporations filing consolidated returns in this state, and the removal of the fifty percent requirement from the statute would negate this intent. If the legislature had intended to permit the "wide open" filing of consolidated returns in Missouri, it would never have included the fifty percent provision in the first place. Moreover, the elimination of this option would be entirely consistent with the United States Constitution. *Cf. Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. 207, 222-223, 100 S. Ct. 2109, 2129, 67 L.Ed.2d 66 (1980). Thus, if the fifty percent requirement is declared unconstitutional, then the offending provisions cannot be properly severed from the remainder of the subsection.

3. The decision of the Supreme Court of Missouri concerning the taxation of capital gain earned by Williams Pipeline Company from the sale of stock in Wood River Pipeline Corporation, is consistent with the decisions of this court, and does not present a substantial federal question to support granting of the petition.

The Missouri Administrative Hearing Commission and the Missouri Supreme Court both found that the record in this case supported the conclusion that capital gains derived from the sale of stock in Wood River Pipeline Corporation ("Wood River") constituted "business income" for William Pipeline Company ("WPL"). This finding was based on the conclusion that WPL

and Wood River were engaged in a unitary business. Petitioners contend that this finding is inconsistent with the due process clause, because WPL did not own a controlling stock interest in Wood River.

Contrary to the petitioners' assertions, however, the decisions of this Court do not set forth such a "bright line" test for determining when capital gains constitute business income from a unitary business. *See Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 178, 103 S. Ct. 2933, 2947, 77 L.Ed.2d 545 (1983). *Cf. ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 321, 102 S. Ct. 3103, 3111-3112, 73 L.Ed.2d 787 (1982). Instead, this Court has espoused a pragmatic approach, which takes many factors into account. In *Container Corp*, this Court stated that "the unitary business concept is . . . not, so to speak, unitary: there are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach." 463 U.S. at 167. This Court also noted that "the unitary business principle could apply, not only to vertically integrated enterprises, but also to a series of similar enterprises operating separately in various jurisdictions, but linked by common managerial or operation resources that produced economies of scale and transfer of value." 463 U.S. at 166. The due process principles set out above require:

> [T]hat the out of state activities of the purported 'unitary business' be related in some concrete way to the in-state activities. The functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation—which renders formula apportionment a reasonable method of taxation.

463 U.S. at 166. Due process also requires "some bond of ownership or control uniting the purported 'unitary business.' " *Id.*

This Court in the *Container Corp.* case also approved a reasonable administrative presumption that corporations engaged in the same line of business are unitary. 463 U.S. at 178. "When a corporation invests in a subsidiary that engages in the same line of work as itself, it becomes much more likely that one function of the investment is to make better use—either through economies of scale or through operational integration or sharing of expertise—of the parent's existing business-related resources." *Id.*

The factors which this Court considered in *Container Corp.* in determining whether a parent and its subsidiaries constituted a unitary business included:

> appellant's assistance to its subsidiaries in obtaining used and new equipment and in filling personnel needs that could not be met locally, the substantial role played by appellant in loaning funds to the subsidiaries and guaranteeing loans provided by others, the 'considerable interplay between appellant and its foreign subsidiaries in the area of corporate expansion,' the 'substantial' technical assistance provided by appellant to the subsidiaries, and the supervisory role played by appellant's officers in providing general guidance to the subsidiaries. (Citations omitted)

Container Corp., 463 U.S. at 179. This Court went on to say that:

> We need not decide whether any one of these factors would be sufficient as a constitutional matter to prove the existence of a unitary business. Taken in combination, at least, they clearly demonstrate that the state court reached a conclusion "within the realm of permissible judgment."

463 U.S. at 179-180.

Under this definition, Wood River was part of WPL's unitary business. Wood River and WPL were linked by operational resources that produced economies of scale and transfer of value. "Wood River was a joint venture by which Koch and WPL were able to accomplish an operational purpose otherwise outside of their respective capabilities." Petitioners' Brief at 44a. Wood River and WPL were both pipeline companies. *Id.* Wood River served to reduce WPL's overhead "and increase the profitability of WPL's existing pipelines in the shared rights-of-way." *Id.* Wood River also converted a $37 million dollar expenditure by WPL into a profit. *Id.* Furthermore, "[t]he Wood River line was available to WPL, and WPL used it for several months." *Id.* at 45a.

It is true that Koch, not WPL, controlled the Board of Directors. *Id.* Koch owned all of the common stock of Wood River which entitled Koch to elect four directors, while WPL owned all of the preferred stock which allowed WPL to elect one director. *Id.* at 30a. This fact was not overlooked by the Missouri Administrative Hearing Commission, or the Missouri Supreme Court; instead, they properly noted that it was just one consideration in determining the scope of the unitary business.

Furthermore, the *Container Corp.* opinion also indicates that control may be implicit. 463 U.S. at Note 16. In this case, the record establishes that WPL was in physical control of at least two segments of the pipeline. The pipeline was constructed on WPL's right-of-way. Petitioners' Brief at 30a, 31a. "WPL managed the day to day affairs of the Bethany-Mason City and Mason City-Pine Bench and Cottage Grove Pipelines." *Id.* at 32a. Wood River appointed WPL as its agent for these pipelines. *Id.* WPL also agreed to perform inspections, repairs and maintenance for Wood River on these pipelines. *Id.* at 31a. All of these findings by the trier of fact in this case, the Missouri Administrative Hearing Commission, point to physical control of the pipeline by WPL. Moreover, as petitioners note in their

brief, "if Wood River did not pay any preferred dividend within 36 months of its schedule declaration date, it would be in 'default.' If default occurred, the board of directors would be reconstituted so as to provide WPL with control." Petitioners' Brief at 11-12.

In sum, the facts of this case do not support the conclusion that WPL's interest in Wood River Pipeline was "merely a passive investment." 463 U.S. at 166. The finding that Wood River and WPL constituted a unitary business and that the gains derived from the sale of Wood River stock was business income, are entirely consistent with the due process clause and this Court's opinions.

CONCLUSION

For these reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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